



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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November 9, 2011

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

FROM: Wendy L. Watanabe
Auditor-Controller

Wendy L. Watanabe
by Schneiderman

SUBJECT: **INTERNAL SERVICES DEPARTMENT – REVIEW OF COMMITMENT
ENCUMBRANCES, ACCOUNTS PAYABLE, AND TRUST ACCOUNTS**

As part of our ongoing responsibility to ensure the County's resources are safeguarded, and that departments comply with County fiscal policies and procedures, we are reviewing County departments' use of commitment encumbrances (commitments), accounts payable, and trust accounts. Our reviews are intended to ensure departments are controlling and using commitments, accounts payable, and trust accounts in compliance with the County Fiscal Manual (CFM) and other requirements.

We have completed a review of the Internal Services Department (ISD). Our review included interviewing ISD personnel, analyzing commitment and accounts payable balances, examining trust account records, and evaluating trust account oversight.

Summary of Findings

ISD generally uses trust accounts for appropriate purposes. However, ISD management needs to strengthen its controls, and ensure they comply with County requirements for commitments, accounts payable, and trust accounts. The following are examples of areas for improvement:

- ISD needs to ensure fiscal staff comply with CFM requirements for establishing and cancelling commitments. We reviewed a sample of 15 commitments, and noted that seven (47%), totaling \$571,900, should have been cancelled.

Cancelling unneeded commitments increases the County's available fund balance, which can be rebudgeted for future spending.

ISD's attached response indicates they have taken corrective action by reinstructing staff on CFM requirements for establishing commitments. In addition, the Department will meet with staff near the end of each fiscal year to reinforce the requirements. ISD also indicated that they have cancelled the seven commitments noted above, and have assigned staff to be responsible for reviewing commitments, and cancelling any that are no longer needed.

- ISD fiscal staff should only establish accounts payable if the items are received, but not paid for, before the end of the fiscal year. We reviewed a sample of 15 accounts payable, and noted that ISD should not have established two (13%) payables, totaling \$16,100, because the items were not received before the end of the fiscal year.

ISD's attached response indicates they have taken corrective action by reinstructing staff on CFM requirements for establishing accounts payable. In addition, the Department will meet with staff near the end of each fiscal year to reinforce these requirements.

- ISD needs to develop and maintain detailed subsidiary ledgers and a control account (trust records) for their trust accounts, and reconcile the trust records to eCAPS monthly. We noted that ISD did not have detailed records for six trust accounts, and the reconciliations were limited to comparing eCAPS reports to hard copy deposit, transfer, and disbursement documents.

ISD's attached response indicates they have taken corrective action by developing detailed records for all trust accounts, and reconciling the records to eCAPS and Treasurer and Tax Collector reports monthly.

Details of our review, along with recommendations for corrective action, are attached (Attachment I).

Review of Report

We discussed the results of our review with ISD management. They generally agreed with our findings and recommendations, and indicated that they will work to improve controls over their commitments, accounts payable, and trust accounts. ISD's attached response (Attachment II) describes the corrective actions they have taken, or plan to take, to address the recommendations in our report.

Board of Supervisors
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We thank ISD management and staff for their cooperation and assistance during our review. Please call me if you have any questions, or your staff may contact Robert Campbell at (213) 253-0101.

WLW:JLS:RGC:MWM

Attachments

c: William T Fujioka, Chief Executive Officer
Tom Tindall, Director, Internal Services Department
Audit Committee
Public Information Office

**INTERNAL SERVICES DEPARTMENT
REVIEW OF COMMITMENT ENCUMBRANCES, ACCOUNTS PAYABLE, AND
TRUST ACCOUNTS**

Background

The Internal Services Department's (ISD or Department) Finance Division is responsible for the Department's commitment encumbrances (commitments), accounts payable, and trust accounts. At the end of Fiscal Year (FY) 2008-09, ISD had \$39.6 million in commitments that were established to pay for goods and services that had been ordered or contracted for, but had not been received, by the end of the fiscal year. ISD also had \$6 million in accounts payable for goods and services that had been received, but had not been paid for, by the end of the fiscal year. In addition, as of June 30, 2009, ISD had seven trust accounts, totaling \$11.1 million.

Scope of Review

We have completed a review of ISD's use of commitments, accounts payable, and trust accounts. Our review was intended to ensure ISD was using commitments, accounts payable, and trust accounts in compliance with the County Fiscal Manual (CFM) and other requirements. Our review included interviewing ISD personnel, analyzing commitment and accounts payable balances, examining trust account records, and evaluating trust account oversight.

Commitments and Accounts Payable

County departments establish encumbrances to reserve budgeted funds when goods and services are ordered. At the end of each fiscal year, encumbrances are carried forward to the next year as commitments if the goods and services have been ordered, but are not received, by the end of the fiscal year.

Departments also establish accounts payable for goods and services that have been received, but are not paid for, by the end of the fiscal year. While accounts payable are automatically cancelled at the end of the subsequent year, commitments are carried forward to future years. Departments are supposed to review their commitments and accounts payable to ensure they are accurate, and cancel any commitments and accounts payable that are no longer needed. Outstanding commitments and accounts payable reduce the County's available fund balance.

Commitments

As noted earlier, at the beginning of FY 2009-10, ISD had approximately 1,900 commitments, totaling approximately \$39.6 million. We noted that \$11.3 million (29%) of the commitments were more than one year old, and \$1.4 million (4%) were more than three years old. Commitments outstanding for more than one year may not be needed,

since departments generally receive goods and services within a year of placing an order.

We reviewed 15 commitments, totaling \$2.8 million, and noted seven (47%), totaling \$571,900, that should have been cancelled. Five of the seven commitments should never have been established because the goods/services were never ordered. The other two commitments were no longer needed because ISD had received and paid for all of the services they ordered, or had already paid for the services using another encumbrance. We also noted that ISD should have reduced one commitment by \$138,600, since another County department had already paid for some of the services.

We also reviewed 15 payments charged against other commitments, and noted that six payments (40%), totaling \$613,100, were for goods and services that ISD had received before the end of the prior fiscal year. ISD should have established accounts payable, and not commitments, for these items. Inappropriately recording commitments, instead of accounts payable, understates prior year expenditures, and overstates subsequent year expenditures. In addition, for four (27%) of the commitments, ISD encumbered funds totaling \$598,800, but did not order the items until the next fiscal year. As a result, budgeted funds from one fiscal year were used to purchase items in subsequent years. We also noted one commitment where the Department encumbered \$391,200 for an order totaling only \$309,000, resulting in an over-encumbrance of \$82,200. Finally, we noted that ISD paid a vendor \$10,000 more than the invoice amount for one purchase. After our review, ISD contacted the vendor, who refunded the overpayment.

Accounts Payable

ISD established an average of \$10.5 million in accounts payable in FYs 2005-06, 2006-07, and 2007-08, of which an average of approximately \$1.2 million (12%) per year was never used. ISD also established \$6 million in accounts payable at the end of FY 2008-09. We reviewed 15 of these payables, and noted that ISD should not have established two (13%) payables, totaling \$16,100, because they did not receive the items until the subsequent fiscal year. In these two cases, the Department should have established commitments at the end of the fiscal year because the items were not received before the end of the year.

Recommendations

ISD management:

- 1. Instruct fiscal staff on County Fiscal Manual requirements for establishing encumbrances and commitments.**
- 2. Ensure that accounts payable are only established if goods and services are received by fiscal year-end.**

- 3. Review commitments and accounts payable to ensure they are accurate for budget and expenditure recognition purposes, and cancel or reduce commitments and payables that are no longer needed.**

Trust Accounts

ISD had seven trust accounts that were used to account for parking lot receipts, collections against accounts receivable, settlement funds for energy efficiency projects, and other earned and unearned revenue. As of June 30, 2009, ISD had \$11.1 million in their trust accounts. Approximately \$10.6 million was held in the Department of Water and Power (DWP) Energy Settlement trust account, which was used to fund qualified energy efficiency projects. The DWP Energy Settlement trust account, only had interest earnings posted to it, and no other activity, during the year.

Trust Account Oversight

Departments use trust accounts for a number of purposes, including temporarily holding revenue until it is earned and/or allocated to appropriate entities/accounts, and holding funds that belong to other parties. Departments should keep documentation indicating the purpose and authority of each trust account to ensure that trust transactions are recorded in the appropriate accounts. We noted that ISD could not locate the documentation for one (14%) of its trust accounts. The Department indicated that the documentation was missing because the account was established before ISD was created in 1989. We also noted that ISD incorrectly used part of one trust account as a pass-through for disbursing and transferring funds from other trust accounts.

CFM Section 2.3.0 requires departments to maintain detailed subsidiary ledgers and a control account for each trust account (trust records), and perform a monthly reconciliation to the County's official accounting records (eCAPS). ISD did not have detailed trust records for six (86%) trust accounts, and their reconciliations were limited to comparing eCAPS reports to hard copy deposit, transfer, and disbursement documents. While we did not identify any material misstatements during our review, the reconciliation method may not identify missing deposits, inappropriate disbursements and transfers, or other errors (e.g., transpositions, duplicate transactions, etc.) in a timely manner.

The CFM also requires that trust account reconciliations be reviewed and approved by a supervisor with no other trust responsibilities. However, we noted that the individual who approved ISD's trust account reconciliations also approved trust disbursements.

Recommendations

ISD management:

4. **Develop and maintain documentation indicating the purpose and authority of each trust account, and ensure that trust accounts are used correctly.**
5. **Develop and maintain detailed subsidiary ledgers and a control account for all trust accounts, and reconcile the records to eCAPS monthly.**
6. **Ensure trust account reconciliations are reviewed and approved by a supervisor with no other trust account responsibilities.**

Revenue and Disbursements

CFM Section 9.1.6 requires departments to initially deposit unearned revenue and funds, for which a revenue source cannot be identified, into trust accounts. Departments should transfer the funds to revenue when they are earned, and/or a revenue source is identified, and should not postpone transfers until subsequent fiscal years. In addition, trust account disbursements must have two approvals, and supporting documentation must be marked “paid” to prevent reuse. We reviewed ISD’s trust account transactions, and noted the following:

- **Earned Revenue in Trust Account at Fiscal Year End** – One trust account had \$50,200 of earned revenue in it at fiscal year-end. While ISD recorded accounts receivable to recognize the revenue, they did not transfer the funds out of the trust account to reduce the receivables, and recognize the cash, at the end of the year. This overstated ISD’s accounts receivable, and understated cash in the County’s year-end accounting records.
- **Revenue Transfer Delays** – We reviewed 11 transfers from trust to revenue, and noted that one transfer, totaling \$860,900, was made 62 days after the revenue was earned.
- **Inadequate Disbursement Controls** – One ISD employee could provide all required eCAPS approvals for trust disbursements between \$25,000 and \$100,000.
- **Disbursement Supporting Documentation not Cancelled** – For the 15 disbursements we reviewed, ISD did not mark supporting documentation “paid” to prevent duplicate payments. While none of the disbursements appeared to be paid twice, ISD should have cancelled the documents to prevent reuse.

ISD management should instruct fiscal staff to transfer earned revenue held in trust to appropriate revenue accounts timely. ISD management should also ensure that each employee can only provide one eCAPS payment approval for trust disbursements, and supporting documentation is marked “paid” to prevent reuse.

Recommendations

ISD management:

- 7. Instruct fiscal staff to transfer earned revenue held in trust to revenue accounts timely.**
- 8. Ensure each employee can only provide one eCAPS payment approval for trust disbursements.**
- 9. Ensure that trust disbursement supporting documentation is marked “paid” to prevent reuse.**

Internal Control Certification Program

The Auditor-Controller developed the Internal Control Certification Program (ICCP) to assist County departments in evaluating and improving internal controls over fiscal operations. Departments must review and evaluate controls in key fiscal areas annually, and certify that proper controls are in place, or that action is being taken to correct any deficiencies or weaknesses noted.

Many of the issues we noted in ISD’s commitment, accounts payable and trust account operations should have been identified when ISD completed the ICCP for FY 2008-09. However, their certification did not identify all control weaknesses. ISD management should ensure that the ICCP questionnaires are accurately completed, all internal control weaknesses are identified and an improvement plan is developed to address each weakness.

Recommendation

- 10. ISD management ensure the ICCP questionnaires are accurately completed, all internal control weaknesses are identified and an improvement plan is developed to address each weakness.**



TOM TINDALL
Director

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INTERNAL SERVICES DEPARTMENT

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"To enrich lives through effective and caring service"

April 4, 2011

To: Wendy L. Watanabe
Auditor-Controller

From: Tom Tindall
Director

A handwritten signature in cursive script, appearing to read "Tom Tindall", is written over the printed name.

Subject: **RESPONSE TO THE A-C REVIEW OF COMMITMENTS, ACCOUNTS
PAYABLE AND TRUST ACCOUNTS**

Attached are our responses to the findings and recommendations contained in your report.

We thank your audit staff for their professionalism and objectivity during the review. If you need any additional information, please contact me or your staff may contact Dave Yamashita at (323) 267-2136 or via email at dyamashita@isd.lacounty.gov.

TT:DY:rc
Attachment

INTERNAL SERVICES DEPARTMENT

RESPONSE TO THE AUDITOR-CONTROLLER AUDIT REPORT COMMITMENTS, ACCOUNTS PAYABLE AND TRUST ACCOUNTS

Recommendation 1: Instruct fiscal staff on County Fiscal Manual requirements for establishing encumbrances and commitments.

ISD Response:

We concur.

ISD Fiscal staff have been reinstructed on the proper manner of establishing encumbrances, commitments, and accounts payable, in accordance with the County Fiscal Manual (CFM) requirements.

Additionally, annual meetings in preparation for the fiscal year-end processes will be held with ISD Fiscal staff to reinforce the CFM requirements for establishing encumbrances, commitments, and accounts payables. These meetings typically commence in March of every year continuing through fiscal year end.

Target Date: Completed

Recommendation 2: Ensure that accounts payables are only established if goods and services are received by fiscal year-end.

ISD Response:

We concur.

See ISD response to Recommendation 1.

With eProcurement, open commodity-based encumbrances (purchase orders) with receiving documents entered in eCAPS are automatically converted to accounts payables at fiscal year-end. Since this process is no longer established manually at fiscal year-end, it will minimize the same type of errors identified during the audit when establishing accounts payables. Additionally, open accounting-based encumbrances (non-commodity) are reviewed by ISD Planning and Administration Managers and the ISD General Accounting Section Manager to ensure that accounts payables are accurately categorized and established in eCAPS.

Target Date: June 30, 2011

Recommendation 3: Review commitments and accounts payable to ensure they are accurate for budget and expenditure recognition purposes, and cancel or reduce commitments and payables that are no longer needed.

ISD Response:

We concur.

The ISD General Accounting Section Manager will be responsible for reviewing and ensuring that the encumbrances are categorized correctly prior to establishing commitments and accounts payables in eCAPS. In addition, the ISD General Accounting Section Manager or a designated supervisor will work closely with ISD Planning and Administration Managers to validate the justifications for establishing or maintaining commitments and payables and to cancel or reduced the commitments and payables that are no longer needed.

Additionally, the seven commitments totaling \$571,900 have been canceled as noted in the audit report.

Target Date: June 30, 2011

Recommendation 4: Develop and maintain documentation indicating the purpose and authority of each trust account, and ensure that trust accounts are used correctly.

ISD Response:

We concur.

Trust account TK7-7184 was established prior to ISD becoming a department in 1989. The original historical documentation could not be located in ISD's current files or in Auditor-Controller Accounting Division's records. ISD had redeveloped the documentation for the current purpose and authority for TK7-7184, which was submitted and accepted by the Auditor-Controller Accounting Division.

Additionally, in July 2010, ISD has corrected its trust warrant payment process and implemented procedures to ensure that TK7-7184 is not used as a pass-through for disbursing funds as noted in the audit report.

Furthermore, the ISD General Accounting Section Manager will be responsible for maintaining the documentation and ensuring that each trust account is controlled and disbursed in conformance with the purpose and authority for which it was established.

Target Date: Implemented

Recommendation 5: Develop and maintain detailed subsidiary ledgers and a control account for all trust accounts, and reconcile the records to eCAPS monthly.

ISD Response:

We concur.

ISD performs trust account reconciliations on a monthly basis. Subsidiary ledgers are now in use for all of the trust accounts where each deposit, transfer, and disbursement is posted to the subsidiary. These ledgers are reconciled to eCAPS and TTC reports at the end of each month.

Target Date: Completed

Recommendation 6: Ensure trust account reconciliations are reviewed and approved by a supervisor with no other trust account responsibilities.

ISD Response:

We concur.

Effective February 2011, the responsibility for reviewing and approving the trust account reconciliations has been assigned to the General Accounting Unit Supervisor, who does not have any other trust account responsibilities, including trust warrant approval capabilities in eCAPS. The eCAPS Financial Workflow Roles had been updated with this change.

Target Date: Completed

Recommendation 7: Instruct fiscal staff to transfer earned revenue held in trust to revenue accounts timely.

ISD Response:

We concur.

ISD Fiscal staff has been instructed to transfer funds to the appropriate revenue accounts timely after the revenue sources are identified. To ensure that transfers are timely, ISD General Accounting Unit Supervisor will review the monthly trust account reconciliations and follow through on reconciling items. In addition, ISD is currently revising its fiscal year-end procedures to include the review of reconciling items and trust deposits posted in June of every year to ensure that the funds are transferred prior to the fiscal year-end.

Target Date: June 30, 2011

Recommendation 8: Ensure each employee can only provide one eCAPS payment approval for trust disbursements.

ISD Response:

We concur.

ISD evaluated the eCAPS Financial Workflow Roles and made the appropriate changes to ensure that each employee can only provide one eCAPS payment approval for trust disbursements.

In ISD's effort to continuously comply with this requirement, ISD's System Support Section of the Finance Division will generate and distribute ISD's eCAPS Financial Workflow Roles on a semi-annual basis. The responsibility of reviewing and evaluating the appropriateness of the trust warrant approval levels has been assigned to the ISD General Accounting Section Manager. Following his review, he will coordinate any changes needed with the System Support Section.

Target Date: Completed

Recommendation 9: Ensure that trust disbursement supporting documentation is marked "paid" to prevent reuse.

ISD Response:

We concur.

ISD Fiscal staff had been instructed and is now consistently stamping "paid" on the documentation supporting disbursements from trust funds. In addition, the date paid and eCAPS document numbers (for example, the Trust Warrant document number) are marked on the documentation for tracking and auditing purposes.

Target Date: Completed

Recommendation 10: ISD management ensures the ICCP questionnaires are accurately completed, all internal control weaknesses are identified and an improvement plan is developed to address each weakness.

ISD Response:

We concur.

ISD will ensure that the ICCP questionnaires are accurately completed and that all internal control weaknesses are identified. Upon completion of the next ICCP questionnaires, ISD Finance management and Internal Affairs will analyze the

questionnaires thoroughly, including a review of sample transactions, to ensure its integrity and to develop an action plan to address each weakness.

Target Date: May 31, 2011